DOCUMENT RESUME

ED 387 892 EA 027 086

AUTHOR House, Jess E.
TITLE School District Response to the Ohio Local Option Income Tax.
PUB DATE Mar 90
NOTE 13p.; Paper presented at the Annual Meeting of the American Educational Finance Association (Las Vegas, NV, March 15-16, 1990).
PUB TYPE Speeches/Conference Papers (150) -- Reports - Evaluative/Feasibility (142)

EDRS PRICE MF01/PC01 Plus Postage.
DESCRIPTORS Economic Impact; Educational Finance; Elections; Elementary Secondary Education; *Finance Reform; Financial Support; *Income; Local Issues; *Property Taxes; *School Districts; *State Legislation; *Tax Effort; Tax Rates
IDENTIFIERS *Ohio

ABSTRACT

Ohio State Senate Bill 28 allows school districts, with voter approval, to impose a tax on the incomes of district residents. This paper examines the early response of school districts to the opportunity presented by the legislation. The paper explains the Ohio system for funding public schools, with a focus on revenue growth, describes features of Ohio local income-tax legislation, and presents results of local income-tax elections held in 1989-90. Data show that the average approval rate for income-tax proposals was 20 percent, compared with a 48 percent average for approval of property-tax proposals. Twenty-one districts approved the income tax in the first two elections, comparing favorably to six districts that approved income-tax proposals in 1982-83. The greater number of successful income-tax initiatives indicates growing acceptance of the tax for school operations. The income tax appeals to school officials because it is not subject to the tax-rate reduction that is imposed on property tax rates, thus decreasing the need for school districts with income-tax revenues to seek approval of tax increases. Moreover, the income tax creates a less onerous tax climate for business. However, a substantial shift in the burden of taxation could occur if the income tax became widely accepted, shifting away from business taxpayers and onto individual, nonbusiness taxpayers. One table is included. (Contains 21 references.) (LMI)

****
* Reproductions supplied by EDRS are the best that can be made *
* from the original document. *
****

ED 387 892

School District Response to the Ohio Local Option Income Tax

Jess E. House

University of Toledo

A paper presented at the annual conference of the

American Educational Finance Association

Las Vegas, Nevada

March 17, 1990

EA 027086

BEST COPY AVAILABLE

School District Response to the Ohio Local Option Income Tax

Introduction

An important component was added to the tax base available to Ohio school districts recently when legislation permitting a local option income tax became law. Senate Bill 28 allows school districts, with voter approval, to impose a tax upon the incomes of district residents. This paper examines the early response of school districts to the opportunity presented by Senate Bill 28. In the first of four sections, a description of the Ohio system for funding public schools is given, with particular attention to revenue growth. The second section describes features of Ohio local income tax legislation. The third section presents the results of local income tax elections held in 1989-1990 and a discussion of the results. In the final section, implications of the legislation are discussed.

Ohio School Finance System

As true with other states, the funding system for Ohio schools depends primarily on state and local revenues, augmented by a modest allocation from the federal government. Together, state and local revenue sources provided 95.2% of revenue to Ohio public school districts during Fiscal Year 1989. The state provided 45.4%, or an estimated $3,370,000,000 of operating revenues, and local revenue sources accounted for the remaining 49.8%, or about $3,695,000,000[1]

State aid is comprised of basic aid and categorical aid. Basic aid is determined by a modified foundation formula, and the so-called categorical aid is actually unrestricted aid that is based on the number of approved units of instruction in the areas of special, vocational, and gifted education. Basic aid accounts for approximately 60% of state aid, categorical aid accounts for about 30%, and the remaining 10% is designated for more than 30 small categorical programs.[2]

The foundation level has been set at $2,530 for Fiscal Year 1990 and at $2,636 for Fiscal Year 1991. Increases in the foundation level provide an indication of growth in revenue from the state. Because

---

[1] Franklin B. Walter, Fact Sheet on Ohio Public Schools (Columbus, Ohio Department of Education, 1989).

[2]Testimony from William L. Phillis, Assistant Superintendent of Public Instruction, before the Education Subcommittee of the Ohio House Finance Committee, 1989, pp. 11-12).

the state equalizes local revenues from required millage at the foundation level, districts with lower assessed valuations receive greater amounts of aid; and, as a consequence, are more dependent on state aid for overall revenue growth. The average annual increase in the foundation level from Fiscal Year 1984 through Fiscal Year 1989 was 5.86%. The smallest increase in the foundation level, however, occurred in 1988, when the foundation level increased by just 2.01%. The next lowest increase, 3.51%, took place the following year. These two years of relatively low increases were particularly onerous for districts which depend on state aid for a high proportion of their revenue.

Nearly all of the estimated $3.7 billion of local revenue was obtained from tax levies upon real and tangible personal property. Tangible personal property consists of the materials, equipment, and inventories used in business. The property tax rate is a composite of unvoted, or inside, millage, usually set between four and six mills, and voted, or outside, millage. Together, inside and outside millage is called authorized millage. Authorized millage is levied against tangible personal property and public utility property. Before authorized millage is levied against real property, however, the millage rate is first reduced.

Real Property Revenue Constraints

If Howard Jarvis' Proposition 13 in California was the epicenter of the property tax revolt that shook the structure of school funding in the summer of 1978[3], then preliminary tremblors were felt in Ohio two years earlier. Property values, particularly residential property, had been increasing rapidly following valuation updates. Because tangible personal property was not revalued, the share of the tax burden experienced by real property owners became larger. In 1976, protests from citizens over higher property tax bills led to the enactment of House Bill 920. The law required that a reduction be made in the voted millage rate equal to the increase in the value of school district real property, following an update in property values. Moreover, annual adjustments of property values were discontinued in favor of a three year cycle of reappraisal or reassessment. The law also mandated that assessed value of tangible

[3]John F. Due, "Shifting Sources in Financing Education," in McMahon, W. W. & Geske, T. G. (eds.) Financing Education: Overcoming Inefficiency and Inequity (Chicago: University of Illinois Press), p. 275.

personal property be reduced by two percent a year from between 45 to 50% of true value, until tangible personal property was assessed at the same percentage as real property, 35%.[4]

A new shift in the tax burden soon became apparent. The tax burden experienced by owners of residential and agricultural property increased at a higher rate than the burden experienced by owners of commercial and industrial property. A constitutional amendment was passed in 1980 that established two separate classes of real property and required the calculation of two separate effective millage rates for the classes. The voted millage rate is adjusted following property reassessment, so that tax revenue does not increase as a result of increases in the total value of either class of existing real property.

Generally, school districts are prevented from benefitting from inflationary increases in real property values. There are, however, several avenues for revenue growth from real property. (1) House Bill 920 does not reduce inside millage, and additional revenue is obtained from inside millage applied against updated property values. (2) Improvements and additions to the stock of real property in the district generate revenue growth. (3) Millage from new levies results in revenue growth. (4) House Bill 920 prohibits the reduction of authorized millage below 20 mills. As a consequence, districts with authorized millage at 20 mills receive revenue increases in proportion to increases in the assessed value of real property.

Tangible Personal Property Revenue Constraints

Another schedule of reductions in the rate used for assessment of tangible personal property was established by House Bill 291, passed in 1984. This bill provided for a one percent annual reduction until the rate reaches 25% in 1993. As an example, tangible personal property with a true value of $100 had a taxable value of $33 in 1984: but in 1993, property of the same market value will have a taxable value of only $25.

Because property tax rates vary across the nation, the tangible personal property can be considered a differential tax. Tax policy that provides for the reduction of assessment ratios may stem, in

---

[4]Robert G. Stabile, What Every Ohio Citizen Should Know About School Finance (Westerville, Ohio: Ohio School Boards Association, 1976 revision), p. 33.

part, from an awareness that capital is not perfectly inelastic. In other words, owners of tangible personal property are able to locate their facilities in areas where their after-tax profits are the highest. The realization that the economic actors are mobile stimulates a concern that this type of tax may act to reduce the supply of capital. By way of comparison with Ohio, thirty-seven states completely exempt inventories from taxation, two states exempt manufacturing inventories, and nine states partially exempt inventories.[5] State policy makers have reason to be concerned about the effect of tax policy on decisions made by business to locate within a state. Although Ohio is considered a major industrial state, manufacturing employment has decreased by 244,169 (18.2%) from 1977 through 1987.[6]

Although both unvoted tax increases on real property and taxation of business capital are undesirable to property taxpayers, the combination of real property millage reductions and personal property assessment reductions placed severe constraints on local revenue growth. For many Ohio districts over the past fifteen years, voter approval of new property tax millage has been essential to meet perennially rising expenditure levels. When districts are unable to pass needed levy increases and lack sufficient funds to operate for the entire school year, they must apply for the approval of the State Controlling Board to seek a commercial loan. The 31 school districts in Ohio in such dire financial straits during 1989 indicate the severity of the need for additional revenue.

Events Leading to the Local Income Tax for Schools

Toledo, in 1946, was the first Ohio municipality to levy a local income tax. Since that beginning, the tax has become widely used throughout the state. The income tax is imposed by 231 of the 240 cities and by 260 villages. Only twelve of the cities and villages levy a rate less than one percent. All of Ohio's ten largest cities impose a tax rate of two percent or more. Collections from the municipal income tax in 1986 in the state of Ohio reached a total of $1,477,240,000. The municipal income tax is charged against both the income of individuals and businesses. Individuals are taxed if they work or reside within the city.

---

[5]Ohio Public Expenditure Council, Tangible Personal Property Taxes in Ohio $68 Million Increase in 1986 -- Second Largest Ever (Columbus, August 1987), p. 3.

[6]Ohio Public Expenditure Council, Economic Report (Columbus, May 1989), p. 4.

Voter approval of the tax was necessary in each of the municipalities.

Districts experiencing financial difficulty were given authorization to levy an income tax of up to one percent on personal and corporate income as part of the 1979-1981 biennial funding bill for schools. Only districts that had received a loan from the state loan fund could impose the local income tax, with voter approval.[7]

All Ohio school districts were provided opportunities to levy local income taxes during two separate periods of the eighties. A provision passed in 1981 as part of the biennial school funding bill permitted boards of education, with the approval of the voters, to levy the local option income tax. Unlike municipalities imposing the income tax, school districts tax only the income earned by individuals who reside within the district. Other important features of the legislation were:

1. No ceiling on the tax rate but must be rounded to the nearest quarter of one percent.
2. Tax combined with the state income tax and collected by the Department of Taxation.
3. Tax withheld by employers.
4. Advance payments made to the district by the state.
5. Tax may be repealed by majority of voters[8]

Ohio biennial funding bills are temporary legislation, and the opportunity for districts to levy a tax on income ended for a time when the 1982-1983 bill expired. Six school districts passed income tax levies during the two-year period, one was repealed, and five continue in effect. The remaining five districts have not yet requested approval of additional local taxes.

The limited exercise of the income tax option by school districts and political pressure from municipalities, jealous of their taxing power, combined to forestall the enactment of permanent legislation.[9] When the biennial period ended, school districts were no longer able to levy a tax on income.

---

[7]Robert G. Stabile, What Every Ohio Citizen Should Know About School Finance (Westerville, Ohio: Ohio School Boards Association, 1979 revision), p. 38.

[8]Robert G. Stabile and Paul E. Spayde, What Every Ohio Citizen Should Know About School Finance (Columbus, Ohio: Ohio School Boards Association, 1982 revision), p. 44.

[9]Interview with Andy DePalma, Ohio Department of Taxation, March 2, 1990.

During 1988, however, several groups composed of legislators and business leaders organized for the purpose of studying the Ohio educational system became active. Each of the groups recommended that an income tax, at either the local or state level, be used to raise revenues for education. A group of leading businessmen, the Ohio Education Commission for the Year 2000, recommended that school districts be allowed to levy a local income or sales tax to supplement or replace property taxes and that a one percent increase in the state income tax be adopted to fund new educational programs. The Shoemaker Committee, made up of 18 members of the House of Representatives, recommended that school districts be allowed to seek voter approval of a local income tax levy. The Gillmor Commission was composed of seven members of the Ohio Senate. The commission's report recommended that "...school districts [be permitted] to adopt a voter-approved school district income tax."[10] The accompanying rationale noted that property taxes were unpopular, especially in rural areas, and the income tax would "permit reasonable growth in local revenue."[11]

A related influence on the passage of Senate Bill 28 was the governor's education initiative. As part of the governor's budget recommendations, the governor proposed a constitutional amendment coupled with a one percent increase in the state income tax earmarked for education.

Apparently, the legislature believed that an increase in the state income tax was not likely to succeed, and chose to leave income tax increases for education to the discretion of the local voters. Other reasons have been given for passage of the bill. The great number of unsuccessful levy elections bespoke the unpopularity of additional taxes on property; the educational lobby pressed for reinstatement of the local option income tax; the elderly and farmers in rural districts were expected to support local income taxes; and a local income tax was expected to provide needed local revenue growth.[12] Also, the income tax was seen as a desirable alternative to the property tax because the income tax was based on ability to pay and

---

[10]Ohio, General Assembly, Senate, Final Report of the Gillmor Commission on School Funding and Expenditures: Cupp Panel on School Finance, February 1986, p. 10.

[11]Ibid.

[12]Andy DePalma.

the property tax was not.[13] The primary policy intention of the supporters of the local option income tax appears to have been to allow school boards and registered voters of school districts to raise local revenue by means of a tax on the individual incomes of district residents.

Senator Cupp chaired a panel created by the Gillmor Commission to study educational funding. He later became the sponsor of Senate Bill 28. This permanent legislation, restoring the local income tax option to school districts, became law on June 13, 1989. The provisions of the 1989 local income tax bill are essentially the same as those of the 1981 bill.

Election Results

Thus far, school districts have had two opportunities since the enactment of Senate Bill 28 to place a local option income tax on the ballot: November 7, 1989 and February 23, 1990. One hundred and fifty-eight school operating tax proposals were placed before the voters during the November election. Eighty-two of the proposals asked approval of a local option income tax. Seventeen were successful, for a passage rate of 20.7%.

At the time of the November election, there were 31 school districts that, due to financial difficulty, had been required to borrow money from the Emergency School Advancement Fund (ESAF). Twelve of the ESAF districts sought approval of an income tax, twelve requested approval of additional property tax millage, and one sought both income and property taxes. Two of the districts passed the local income tax, and four passed millage increases. The district with both measures on the ballot failed to pass either of them. The comparison of the approval rate is prejudiced, however, by the other differences in the tax proposals. The income tax continues in effect until repealed. Property tax increases can also be continuing or can be presented as emergency levies, effective for a period of from one to five years. The two continuing property tax levies on the ballot failed, and the successful property levies were emergency levies.

School districts placed 28 operating tax issues on the February 23, 1990, ballot. Thirteen of these asked voters to approve a local income tax, and fifteen sought approval of a property tax increase. Four

---

[13]Interview with Troy Boughan, Legislative Aide to Senator Cupp, March 1, 1990.

of the thirteen were successful, and nine of the fifteen millage requests were successful. One of the 28 districts placed both income tax and property tax proposals before the electorate; the property tax passed, and the income tax failed. Also, two of the ESAF loan districts that tried unsuccessfully in November to pass a 1% income tax were successful in the February election.

The high interest shown in the local option income tax has prompted efforts to gather data concerning the districts that have attempted passage of the tax. The Ohio School Boards Association surveyed the districts which sought approval of the income tax in the November election. In a similar effort, but making use of routinely collected data, the Division of School Finance at the Ohio Department of Education completed a preliminary analysis of the election results. The data were analyzed to identify patterns that would be helpful to other school districts in considering passage of the income tax. Descriptive statistics were employed. Although the analyses from both the OSBA and the Division of School Finance noted that data from additional elections were needed before conclusions could be drawn, several patterns emerged. The OSBA survey indicated that 78% of the successful districts were located in rural communities. Twenty-seven percent of rural districts were successful, 18% of suburban districts were successful, and 8% of small to medium city districts were successful.[14]

The record of success in gaining voter approval of levy issues during the past ten years was not as good for the 82 districts with an income tax on the November ballot as the average of all districts in the state. The 82 districts passed only 39% of their levies over the past 10 years, and the average rate of passage was 48%.[15]

The response of the voters is surprising when compared to prior efforts by school districts to pass the local option income tax. While a 20% average approval rate on income tax proposals compares poorly to the 48% average for approval of property tax issues, the 21 districts that approved the income tax in the first two elections compares quite favorably to the six that were approved in the earlier two-year period

---

[14]Ohio School Boards Association, Income Tax Survey Results, A Report Prepared by the Division of Legislative Services (Columbus: Ohio School Boards Association, 1989).

[15]Division of School Finance, Ohio Department of Education.

(1982-1983). The greater number of successful income tax issues indicates growing acceptance of the tax for school operations. Stronger conclusions await the availability of additional data and the application of more powerful statistical analysis.

Key Implications of the Local Income Tax

Excellent discussions of the characteristics of alternative forms of taxes and relevant concepts such as equity and ability can be found in contributions made by Monk[16], Johns[17], and Benson[18]. The implications considered in this section concern revenue growth and tax burden.

Potential for Revenue Growth

The income tax is not subject to the tax rate reduction that is imposed on property tax rates. If individual incomes within the school district rise over a period of time, the revenue from the income tax will experience a commensurate increase. Of course, revenue will decrease if incomes decline; but the general trend has been one of increasing incomes. The five school districts that passed the income tax in 1982-1983 have not yet found it necessary to seek additional tax increases. The experience of the five districts and projections made by school district officials suggests, at the least, that school districts with income tax revenues may not need to seek approval of tax increases as frequently. This prospect is a highly attractive one to school officials, particularly superintendents.

Income Tax and the Burden of School Taxation

Because the income tax, like the property tax, is a tax on residents of the school district, the district taxpayers in the aggregate experience an impact of the same magnitude whether a tax on income or a tax of an equivalent rate on property is levied. There are, however, important differences in the incidence of the income tax and property tax to be considered, and the potential for revenue growth is substantially different.

The incidence of the income tax results in a different pattern of tax price increases to each resident

---

[16]David H. Monk, Educational Finance: An Economic Approach (New York: McGraw-Hill, 1990).

[17]Roe L. Johns, The Economics and Financing of Education (Englewood Cliffs, NJ: Prentice-Hall, 1983).

[18]Charles S. Benson, The Economics of Public Education (Boston: Houghton-Mifflin).

taxpayer. The tax price is the amount each district resident has to pay if expenditures per pupil were to be increased by one dollar.[19] When the income tax is imposed, the impact of the tax price is shifted according to the ratio of income to property for each taxpayer. For example, an individual with a relatively great property valuation and low income would experience a small tax price increase if an income tax were passed. On the other hand, a second individual in converse circumstances would experience a large increase.

Table 1, Substitution of 1% Income Tax for Property Tax

Present Pattern of Taxation			Substitute 1% Income Tax	
	(Millions)	Percentage	(Millions)	Percentage
Real Property				
Residential/Agricultural	1,743.9	47.2%	1,000.5	27.0%
Business/Industrial	736.2	19.9%	422.4	11.4%
Tangible Personal				
Public Utility	476.8	12.9%	273.6	7.4%
Business	737.9	20.0%	423.4	11.5%
Totals				
Business	1,950.9	52.8%	1,119.3	30.3%
Individual	1,743.9	47.2%	2,575.5 (Includes 1% Income Tax)	69.7%
Grand Total	3,694.8	100.0%	3,694.8	100.0%

A local income tax also redistributes the present share of taxation in another important way, lessening the burden on business and industry and increasing the burden on the non-business taxpayer. Real property and tangible personal property owned by businesses and public utilities accounted for 52.8 percent of the estimated $3,694.8 million in property taxes paid for school operating expenses during

[19]Aaron S. Gurwitz, The Economics of Public School Finance (Cambridge, Massachusetts: Ballinger), p. 40.

calendar year 1989.[20] As an illustration of this shift in tax burden, assume a 1% income tax was adopted in each district in the state. The total statewide personal income for 1987 was $157,497 million,[21] and the 1% tax rate would result in $1,574,970,000 in revenues. If this revenue were substituted for property tax revenue presently being received, the share of taxation borne by business taxpayers would be reduced from 52.8% to 30.3% (See Table 1).

Although the example is hypothetical, it serves to demonstrate that a substantial shift in the burden of taxation to support schools could occur if the income tax became widely adopted. While it is not known whether the school income tax will become as widely used in Ohio as the municipal tax, the general effect of a shift of the burden away from business taxpayers and toward individuals occurs in districts that choose the local income tax option.

Summary

The taxpayer protests of the seventies were the catalyst for legislated constraints on property tax revenues for school districts. Millage reduction for real property, declining assessment ratios for tangible personal property, and the reluctance of voters to approve additional millage combined to create financial hardships for many Ohio school districts. This latent component of the tax base contains the potential to provide an increasing portion of local tax revenues. Along with a broadening of the tax base, the revenues from income tax are not subject to the constraints that limit growth from local property taxes. Moreover, the tax is also desirable from the perspective of those seeking the objective of a less onerous tax climate for business. However, if the school district income tax is as successful as the municipal income tax has been, a great shift in the tax burden will occur. Individuals will shoulder a continually growing share of the tax burden, and the state of Ohio will be less able to shift the tax burden of public education to other states.

---

[20] Ohio Public Expenditure Council, Education Report: School Property Taxes Exceed Inflation 7 of Past 10 Years (Columbus: Ohio Public Expenditure Council, January 1990), p. 2.

[21] Ohio Public Expenditure Council, Economic Report: Ohio Drops to 8th in Personal Income (Columbus: Ohio Public Expenditure Council, November 1989), p. 6.